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**LIABILITY OF DIRECTORS  
ON VOLUNTEER BOARDS**

*Current Issue Paper 152*



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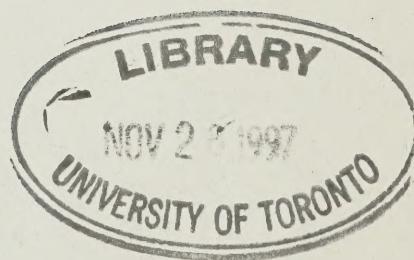
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## INTRODUCTION

A good deal of the charitable, social service, sport and cultural work undertaken in our society is handled not by government or business (although they may fund it), but by volunteer organizations. These community groups are governed by board members, officers, or trustees.

Every Member of the Legislative Assembly will be familiar with such organizations, and will have constituents who serve in them; many Members will have been asked to serve on boards themselves, following a long tradition by which people of talent and public spirit are enlisted to contribute to the community.

The duties can be time-consuming; serving on a board faced with crucial or controversial decisions can be stressful; and time and energy is diverted from family and career. There is another cost to be considered: the risk of personal liability to which the volunteer might be exposed.

If the organization is incorporated, the volunteer is a director of a corporation without share capital under Part III of Ontario's *Corporations Act*. That statute and others, in conjunction with the common law, in principle exposes such directors to some of the personal liabilities increasingly being faced by directors of business corporations. It is true that a not-for-profit corporation is unlikely to discharge industrial waste, and that its directors are not likely to face personal liability under an environmental statute.<sup>1</sup> But not-for-profits do have employees who might be able to seek unpaid wages from the pockets of directors, and who may participate in pensions for whose contributions directors could find themselves personally liable. Not-for-profits do not engage in business, but they do contract for services, goods, and borrowing, and directors can be just as liable as they would be in businesses for an undeclared personal interest in such



contracts. They might also be liable for inducing a breach of a contract—a contract with an unpaid supplier, or one with an angry and litigious former employee. Non-profits do not usually have factories, but they do usually have premises in which employees can be injured.

Prudent plaintiffs will have noted that small non-profit corporations frequently have fewer assets than do their directors; prudent directors should keep that in mind as well.

The chain of liabilities can be more direct in an association that is not incorporated. Members of such an organization could, in some circumstances, find themselves personally liable for debts and other liabilities that might have attached to the organization itself, were it incorporated.

The situation is more complex when the organization is set up under a trust deed. Trustees are required to exercise their discretion solely for the benefit of the beneficiaries of the trust property. The trustees have legal title to the property, but this is for the purpose only of benefitting the beneficiaries. Such a duty to act for the benefit of another rather than in one's own interest is known as a fiduciary duty. Trustees are held to a level of diligence and care which has been characterized as the "care of an ordinary prudent person of business conducting his or her own business."<sup>2</sup> At common law they must exercise their discretion personally and may not delegate their duties. The *Trustee Act* permits delegation to a lawyer or a bank manager for certain purposes (s. 20), but even when acting on professional advice the trustee is held to standards of prudence and care. The standards are in some respects higher than for a corporate director.

Some trustee standards will apply as well to the director of a not-for-profit corporation, whose purposes, as set out in the objects of the corporation, are charitable. A guide to what might be regarded as a "charitable purpose" may be found in s. 7 of the *Charities Accounting Act*: the relief of poverty, education, the advancement of religion, or any other activity beneficial to the community.



This paper will restrict itself to a discussion of the potential liabilities of directors of not-for-profit organizations that have incorporated under Part III of the *Corporations Act*, including those with charitable objects. "Company" or "corporation" will generally mean "incorporated non-profit organization", and unless otherwise specified, references and citations are to Ontario statutes.

The risks facing directors arise out of the activities of the corporation they direct. It is important for a director to be familiar with the objects (the purposes) of the corporation as set out in its letters patent, for these determine what the corporation may do, and what, by implication, should be regarded as beyond its powers.<sup>3</sup> Also helpful in identifying potential problems are certain powers and characteristics of the corporation that are specifically provided for by statute.<sup>4</sup> These include the power to sue and be sued, to contract and be contracted with, the exemption of members<sup>5</sup> from personal liability so long as they do not contravene the statute incorporating them, and certain powers to deal with property. These, by the way, are among the motives an organization might have for incorporating despite the expense and the ongoing burden of meeting statutory duties: incorporation offers the members and directors some insulation, and makes it easier for the association to ensure continuity and to deal with lenders and contractors.

## STATUTORY EXPOSURE TO LIABILITY

Although the physical and financial arrangements that can lead to director liability are more common in business enterprises, some of the statutory provisions creating personal liability—both civil and quasi-criminal—bear attention by members of volunteer boards. What follows is an account of some of these provisions.

### ***Corporations Act***

Directors of not-for-profit corporations are exempted from Part XIV.2 of the *Employment Standards Act*, which deals with the liability of directors for wages in cases where a company is insolvent and in other circumstances (s. 58.19(3)).



Nevertheless, they remain subject to the more modest liability under s. 81 of the *Corporations Act* of up to six months' unpaid wages owed to employees and other wage earners, as well as for vacation pay accrued over a year. This liability arises, for example, if the company owing the wages has gone into liquidation or is under bankruptcy proceedings, and the director can be sued as late as six months after ceasing to be a director.

A director must declare at a board meeting any interest he or she has in any contract (or proposed contract) involving the company. Failing that, unless the contract is confirmed at a meeting of the members of the corporation, the contract is voidable. In that case, the director may be liable to the corporation or to its creditors, and may be guilty of an offence (ss. 71 and 133).

The statute creates a number of offences for which a director could be convicted. These include acquiescing in a failure to inform the Minister of Consumer and Commercial Relations or to publish in *The Ontario Gazette* any resolution changing the location of the headquarter, or altering the number of directors (ss. 277 and 285; \$200 fine). This emphasises how important it is that directors be alertly confident that the affairs of the corporation are being properly conducted.

A director can be fined \$200 upon conviction of an offence of not letting a member examine certain documents, minutes or registers (ss. 304 and 305), and can be punished (\$1,000, 3 months' imprisonment, or both) for making an untrue entry in any such document. It is an offence punishable by a \$1,000 fine to traffic in membership lists (s. 308).

### **Other Statutes**

The *Corporations Information Act* provides that any director who acquiesces in the corporation's contravention of the Act (which requires the filing of prescribed information) commits an offence for which the punishment, upon conviction, can be



\$2,000 (s. 14(2)). The Act applies to corporations "with or without share capital wherever or however incorporated" (s. 1).

Likewise, a director who is convicted of acquiescing in a corporation's contravention of the *Pension Benefits Act* can be fined \$25,000 (ss. 109 and 110). Where the conviction relates to the employer's obligation under s. 55(2) to make payments to a pension fund or insurance company, the director, if convicted, could, in addition to being fined, be ordered to pay the amount the employer had failed to pay.

Under s. 32 of the *Occupational Health and Safety Act*, directors are required to take all reasonable care to ensure that the corporation complies with the Act and regulations, and with any safety orders made under the Act. To the extent that not-for-profit groups are employers, this liability could be of concern. Although most employees of not-for-profit corporations work in fairly benign office surroundings, sports facilities, sheltered workshops and other workplaces associated with not-for-profit corporations can offer more risk. The penalty for a person who fails to comply with the Act can be \$25,000, twelve months' imprisonment, or both (s. 66(1)). There has been a conviction of a director of a business corporation under this provision,<sup>6</sup> but not of a not-for-profit corporation or director.

Under s. 227.1 of the federal *Income Tax Act* a director who has not exercised an (objective) "degree of care, diligence and skill" to prevent a corporation's failure to remit tax withheld from employees may be personally liable. The statute does not distinguish between business and not-for-profit corporations. Furthermore, though the corporation itself is exempt from tax, it must file a return under s. 150(1), or, in the case of a charitable corporation which has been registered under the *Income Tax Act* so as to enable it to issue tax receipts, an information return under s. 149.1.

A consequence of failure to file under s. 149.1 can be deregistration of the charity; if a director were to be found responsible for this, it is possible that he or she could be civilly liable to the corporation for damages, though the law is not clear on this.

## **Additional Considerations: Charitable Corporations**

It has already been noted that where a not-for-profit corporation has a charitable purpose, it may be subject to some of the rules applicable to trustees. While the *Charities Accounting Act* deems a corporation "incorporated for a religious, educational, charitable or public purpose" (s. 1(2)) to be a trustee with regard to charitable property it holds, it does not explicitly characterize the directors of such corporations as trustees. If they were trustees, they would be burdened with a higher standard of care than that required of non-charitable, non-profit directors. It might also mean that like all trustees, and unlike directors, they could not receive remuneration (other than reimbursed expenses) except by the direction of a court. They would be allowed no direct or indirect profit from their relationship to the corporation; there could be no saving confirmation of a contract as under s. 71 of the *Corporations Act* in these circumstances. An Ontario High Court decision suggests that it is indeed the case that a director of a charitable not-for-profit corporation should be treated as a trustee.<sup>7</sup>

## **COMMON LAW EXPOSURE TO LIABILITY**

Another class of risk arises out of the common law duties of not-for-profit directors.

The *Business Corporations Act* codifies the duties a director of a *business* corporation owes the corporation:

- 134.** (1) Every director and officer of a corporation in exercising his or her powers and discharging his or her duties shall
- (a) act honestly and in good faith with a view to the best interests of the corporation; and
  - (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.



The corresponding duties of a not-for-profit corporation's director under Part III of the *Corporations Act* have not been enacted in that statute,<sup>8</sup> and the common law standard, on which s. 134(1) was modeled, applies. There is a difference between the two: whereas s. 134(1)(b) makes the standard of care an objective one (that of "a reasonably prudent person . . . in comparable circumstances"), the common law standard of care is subjective, and requires conduct that could reasonably be expected from the director in question given his or her knowledge and experience.<sup>9</sup> This could be lower, but on volunteer boards it is more likely to be higher. Note also that in the case of the directors of a *charitable* corporation, the duty to act, as s. 134(1)(a) puts it, "with a view to the best interests of the corporation", would certainly have to be applied subject to the trustee-like duties that such a director would have with regard to the funds collected and the charitable objects for which the funds are to be distributed.

The duty to act honestly and in good faith with a view to the corporation's best interest is a fiduciary duty. To establish a breach of this duty, it does not have to be shown "that the fiduciary acted in bad faith since, regardless of such person's good or bad intentions, a breach of the duty of loyalty is the automatic result."<sup>10</sup>

There are areas in which the common law exposure of directors in general to personal liability is expanding.<sup>11</sup> This could possibly affect not-for-profit corporations. One is in the case of a director's breach of the fiduciary duty by pursuing a personal interest that conflicts with the corporation's; the resulting liability could be to the corporation, or to any individual involved.

Another is the possibility that a director might be sued personally in connection with an alleged breach of contract by the corporation. Where it can be shown that the director wrongfully interfered and did something to cause the corporation to breach a contract, a plaintiff might decide (if the director is likely to have more assets than the corporation does) that it makes more sense to sue the director for inducing the breach than to sue the corporation for the breach itself. This could come up, for example, in the case of an former employee who may have been wrongfully dismissed, or in any other kind of contract for services or goods.

## CONCLUSION: PRECAUTIONS

It should be said that for a director on a volunteer board, the risk of exposure to personal liability is not high. The corporate veil has not been swept away entirely. Section 80 of the *Corporations Act* permits a corporation, through a members meeting, to indemnify a director for certain costs and liabilities. In addition, liability insurance is available;<sup>12</sup> it affords more protection than may be practically expected from the not-for-profit corporation itself.

The director can do much to minimize risk by exercising care and diligence in the performance of directors' duties. The director should attend meetings; make sure that any quorum requirement in the by-laws is being met when participating in board decisions; avoid conflicts of interest; carefully examine all documents dealing with employees' compensation, and hiring and firing; be personally satisfied that the books are being independently audited; be familiar with the objects of the corporation; not acquiesce in any activity, expenditure or acquisition that is not supported by the objects or the incorporating statute; and, generally, act within the director's authority. Someone considering serving on a board should be familiar with the other directors. It would probably not be wise to serve on a board whose members' qualifications are limited to the statute's base requirements, in s. 276, that a director be 18 years of age or older, and not be an undischarged bankrupt. A director might be at risk if the board as a whole does not have the right mix of skills needed to perform the board's functions, which a key Canadian guide to the subject describes as follows:<sup>13</sup>

- to manage the affairs of the corporation;
- to ensure that the objects of the corporation are properly carried out and to interpret the organization's object to the public;
- to set long-range objectives and to develop strategic plans;
- to establish policies and guidelines for the operation of the corporation;
- to be responsible for all aspects of the corporations's operations;
- to ensure the corporation's financial stability and assess performance;



- to evaluate the performance of the corporation in the community;
- to establish policies and short-term goals; and
- to communicate the needs of the community to the corporation and to represent the corporation and its financial need to the community.

### SUGGESTED READING

Organizations such as United Way, the Canadian Centre for Philanthropy, and the Trillium Foundation have no written information and advice concerning volunteer boards and their members (though the Centre has resources which can be consulted at their premises). However, Canadian written resources are available. The following are recommended:

Bailey, Dan A., and Katharine B. Bills. "D&O Liability of Nonprofit and Privately-Held Organizations," *Assurances* 61:1 (April 1993): 41. Reprinted from an American publication, *The Risk Report* (October 1992).

Bourgeois, Donald J. *The Law of Charitable and Non-Profit Organizations*. Toronto and Vancouver: Butterworths, 1990.

Burke-Robertson, R. Jane, and Arthur B.C. Drache. *Non-Share Capital Corporations*. Scarborough: Carswell, 1992.

Hatton, Michael J. *Corporations and Directors: Comparing the Profit and Not-for-Profit Sectors*. Toronto: Thompson Educational Publishing, 1990.

Krieger, Steven B. *Duties and Responsibilities of Directors of Non-Profit Corporations*. Toronto: Canadian Society of Association Executives, 1989.

Ontario. Ministry of Consumer and Commercial Relations, Companies Branch, and the Office of the Public Trustee for Ontario, Charitable Property Division. *Not-for-Profit Incorporator's Handbook*. Toronto: The Ministry and the Office, 1993.

## ENDNOTES

<sup>1</sup> As are, increasingly, directors of business corporations, in cases where it can be shown that they had knowledge, authority, and responsibility, and the opportunity to deal with matters before the damage was caused. In *R. v. Bata Industries Ltd.* (1992), 70 C.C.C. (3d) (Ont. Prov. Div.) two directors were convicted under the *Ontario Water Resources Act* and each was fined \$12,000; the corporation was directed not to indemnify the directors despite its power under the *Business Corporations Act* to do so. In *R. v. Varnicolor Chemical Ltd.* (Ont. Prov. Div., 1992; unreported), a director/executive was convicted under the *Environmental Protection Act* and sentenced to eight months in jail.

<sup>2</sup> Donald J. Bourgeois, *The Law of Charitable and Non-Profit Organizations* (Toronto and Vancouver: Butterworths, 1990), p. 74.

<sup>3</sup> But note that the *Corporations Act* appears to give non-profit corporations "the capacity of a natural person" (s. 274); the statutes in some other jurisdictions limit a non-profit's powers to those set out in the instrument creating it.

<sup>4</sup> Part VII of the *Corporations Act*, and those clauses of s. 23(1) of Act specified by s. 133(1) as applying to Part III corporations; and the *Interpretation Act*, s. 27.

<sup>5</sup> The protection of directors is not as comprehensive.

<sup>6</sup> A director of Raglan Industries of Bowmanville pleaded guilty and was fined \$10,000: "Ruling chills biz directors," *Toronto Sun*, 1 March 1994, p. 22.

<sup>7</sup> *Re Toronto Humane Society and Ontario (Public Trustee)* (1987), 40 D.L.R. (4th) 111.

<sup>8</sup> Some provinces have embodied a version of the common law duties for directors of not-for-profit corporations in a statute; others, like Ontario, have not.

<sup>9</sup> This is how the subjective standard was defined by Romer J. in *In re City Equitable Fire Insurance Co.* [1924] All E.R. 485.

<sup>10</sup> R. Jane Burke-Robertson and Arthur B.C. Drache, *Non-Share Capital Corporations* (Toronto: Carswell, 1992), p. 6.11.

<sup>11</sup> M. Norman Grosman, "Common Law Liability of Directors and Officers," *Employment Bulletin* 7 (November 1992), p. 3.

<sup>12</sup> A United Way/Centraide Canada information sheet for member organizations entitled *Association Liability Policy* offers an example of one such policy's coverage and exclusions. *Liability exposure contemplated*: discrimination; wrongful dismissal; acts beyond authority; financial decline; insufficient supervision leading to losses; waste of assets; negligent attention (from missed meetings); false or misleading reports; failure to verify facts in official documents; failure to deliver service; and causing unnecessary tax



liability. *Principal exclusions*: law suits relating to fiduciary liability; bodily injury; property damage; pollution; embezzlement by employee; and wrongful or illegal compensation of staff.

<sup>13</sup> Burke-Robertson and Drache, *Non-Share Capital Corporations*, pp. 5.1-5.2.







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